No. 94-560

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In The

Supreme Court of the United States

October Term, 1994

FIRST OPTIONS OF CHICAGO, INC.,

Petitioner,

vs.

MANUEL KAPLAN, CAROL KAPLAN AND M.K. INVESTMENTS, INC.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF FOR AMICI CURIAE PHILADELPHIA STOCK EXCHANGE, INC., CHICAGO BOARD OPTIONS EXCHANGE, INC. AND PACIFIC STOCK EXCHANGE, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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STATEMENT OF INTEREST OF THE AMICI CURIAE

The Securities and Exchange Commission ("SEC"), pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq.*, has approved arbitration rules of the various self-regulatory organizations ("SROs") under the SEC's oversight.

Accordingly, the SROs have established SRO arbitration forums to resolve disputes between SRO members

and between SRO members and their customers. Each year thousands of disputes are fairly and efficiently resolved through binding SRO arbitrations – disputes that otherwise would clog state and federal court dockets, taxing not only judicial resources, but the parties' pocketbooks as well. So effective has been the SRO administering of securities arbitrations that this Court has provided a ringing endorsement of the program. *See Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989). *See also Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

The Philadelphia Stock Exchange, Inc. ("PHLX"), Chicago Board Options Exchange, Inc. and Pacific Stock Exchange, Inc. are SROs registered with the SEC as national securities exchanges. The PHLX and other amici have established and maintain SRO arbitration programs. The amici have a significant and vital interest in the resolution of the issue in this case, specifically the standard of review to be applied to completed arbitrations.

In the instant case, the Third Circuit has dramatically undercut SRO arbitrators' ability to render final, binding arbitration decisions by allowing a court to re-examine *de novo* whether a dispute is arbitrable after the arbitrators have rendered a final decision regarding the dispute. The Third Circuit's decision in this case contravenes not only the basic contract principles of waiver and estoppel, but the clear federal policy in support of arbitration as a fair and efficient means of final and binding dispute resolution for those parties having submitted a dispute to arbitration.

If allowed to stand, the Third Circuit's decision in this case will inevitably have a deleterious impact on the SRO arbitration programs conducted by the amici, initially by undercutting the efficiency and certainty of binding SRO arbitration decisions, encouraging arbitration forum shopping, and ultimately discouraging willing participation in binding arbitration programs. The result will be that more securities disputes will be directed to the already overburdened courts.

SUMMARY OF ARGUMENT

Once parties have proceeded to the merits of the dispute before the arbitrators, the amici have considered the applicable standard of review of SRO arbitrators' decisions on arbitral jurisdiction to be the same standard accorded to the arbitrators' decisions on the merits of the dispute, namely deference. Essentially, this standard permits the courts to overturn the arbitrators' decisions only for a manifest disregard of the law (or as set forth in the applicable statute). *See Nolde Brothers, Inc. v. Bakery Workers*, 430 U.S. 243, 51 L.Ed. 300, 97 S.Ct. 1067 (1977).

This Court should therefore grant the writ of certiorari and resolve the split in the circuits by reaffirming the deferential standard, which provides that once an arbitration decision is rendered as to the merits of a dispute, all substantive decisions made by the arbitrators that led to the final decision on the merits, including any decision as to the arbitrability of the dispute, should receive deferential review by a court. This standard would be consistent with the policies underlying the

Federal Arbitration Act, the federal securities laws' policy favoring arbitration of securities disputes, and this Court's own preference for securities dispute resolution through SEC approved and regulated SRO arbitration programs.

ARGUMENT

I.

CERTIORARI SHOULD BE GRANTED BECAUSE THE THIRD CIRCUIT DECISION OFFENDS CONTRACT AND EQUITY LAW PRINCIPLES AND UNDERMINES THE SECURITIES ARBITRATION SCHEME

Because the recent Third Circuit decision shocks basic contract law principles relating to whether parties have agreed to binding arbitration, and upsets the entire bedrock of the SRO securities arbitration scheme, the amici concur and join in First Options of Chicago, Inc.'s petition for writ of certiorari.

The amici urge this Court to reaffirm the deferential standard of judicial review of final arbitration awards. This standard requires that, once securities arbitrators have been permitted by the parties before them to render a final decision on the merits of a dispute, all predicate decisions to that final decision, including any decision as to arbitrability of the dispute by the arbitrators, must be judicially reviewed with deference afforded to the arbitrators. The corollary standard would be that if a party seeks to contest whether a matter is arbitrable or whether such party is subject to an agreement to arbitrate, that party must immediately seek a judicial determination as

to such issue[s] and/or expressly reserve such right. Failure to take such actions shall constitute a *per se* waiver or estoppel of any right by any party to *de novo* court review of the issue of arbitrability.

In this and a series of other cases, the Third Circuit and the Ninth Circuit have reasoned that when a party merely objects to whether a dispute is arbitrable yet proceeds with costly, time consuming proceedings to a final decision by the arbitrators on the merits of the dispute, the objecting party has not only not waived the right to a judicial determination of the arbitrability issue, but has allowed the court to conduct a full *de novo* review of the issue of arbitrability, which can totally undermine the entire completed proceeding. *See Pennsylvania Power Co. v. Local Union No. 272*, 886 F.2d 46 (3rd Cir. 1989). *See also Local 719, American Bakery & Confectionery Workers of America, AFL-CIO v. The National Biscot Company*, 378 F.2d 918 (3rd Cir. 1967). *See also George Day Construction Co. v. United Brotherhood of Carpenters*, 722 F.2d 1471 (9th Cir. 1984).

The amici contend that the ramifications of court *de novo* review through the issue of arbitrability after the arbitrators have rendered a final decision based on the dispute's merits, undermines the efficacy of the entire arbitration process. First, a standard of *de novo* review creates substantial unfairness. It encourages arbitration respondents to always raise the jurisdictional objection and then seek a decision on the ultimate merits of the case by the arbitrators. If the respondent prevails on the merits, no judicial appeal is taken. On the other hand, if the respondent loses, the respondent will inevitably appeal and request the court to overturn the arbitration

award through a *de novo* review regarding whether the matter was arbitrable in the first instance. Hence, respondent is unfairly afforded two chances to receive a favorable decision to the claimant's one chance.

Second, significant resources are utterly wasted when an arbitration award is reversed by a court's "second guessing" of arbitral jurisdiction. In this arbitration case alone, thousands of hours were expended by the Exchange arbitration administrators, arbitrators, witnesses and the parties themselves, all to no ultimate avail, in an effort to create a final, binding resolution of the dispute. Those thousands of hours reflect hundreds of thousands of dollars in time and effort wasted. According to the Third Circuit, this case must now be relitigated in court all over again. Affording deference to the arbitrators' award, including the decision on the arbitrability of the dispute, would have appropriately assured binding finality to this case. A deference standard appears to be the only intuitive and logical standard of review, which would be consonant with the strong federal policies favoring binding arbitration dispute resolution and this Court's own preference for securities dispute resolution. *See United Steelworkers of America v. American Manufacturing Company*, 363 U.S. 564, 4 L.Ed.2d 1403, 80 S.Ct. 1343. *See also Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

Third, support of a deferential standard of review over issues regarding arbitrability is well underpinned by basic contract principles. In this regard, the amici contend that the Third Circuit incorrectly interpreted contract law when it found that parties do not expressly or by implication waive their right to *de novo* judicial review of the

arbitrability issue when they merely object to jurisdiction, yet proceed to participate in costly and time consuming proceedings on the merits of the dispute to its conclusion. *See* Restatement Second of Contracts Sec. 84 (1981). *See also Reiter v. Yellowstone County, Montana et al.*, 627 P.2d 845, 850 (1981). Moreover, the amici further assert that by not finding such a waiver, the Third Circuit ignored principles of estoppel and good faith and fair dealing, since all parties not only spent considerable time and money on the arbitration proceedings, but also relied to their detriment on the objecting parties' good faith participation in the binding arbitration proceedings. *See* Restatement Second of Contracts Sections 34, 84, 90 and 205 (1981). *See also Neverett v. Towne*, 159 A.2d 345, 351 (1960).

Fourth, the amici also contend that the lack of uniformity on this issue among the circuits presents problems unique to the securities industry. In this regard, because the amici are located in different parts of the country, and share many of the same members, subjecting them to the decisions of different circuits, allows arbitrations to be brought against and/or by those members in any number of amici-operated arbitration fora. In short, forum shopping will be promoted. Arbitrations will be initiated in any amici forum residing within a "favorable" circuit rather than one with a proper venue.

Finally, the Third Circuit decision places a chilling effect on the arbitral process by encouraging SRO arbitrators to either refuse to accept or to readily dismiss matters involving jurisdictional objections. The practical result is an increase in both state and federal court dockets and a delay in the processing of securities

disputes, which runs afoul of the federal policies favoring fair, efficient and speedy resolution of these cases through arbitration.

For the aforementioned reasons, the amici respectfully request this Court grant the petition for writ of certiorari in order to re-establish a uniform, nationwide standard of deferential review of SRO decisions on the issue of arbitrability, thereby restoring the SRO arbitration fora to their original and intended purpose – swift, just, effective and consistent securities dispute resolution.

CONCLUSION

For the reasons set forth above, amici curiae Philadelphia Stock Exchange, Inc., Chicago Board Options Exchange, Inc. and Pacific Stock Exchange, Inc. respectfully request that this Court grant the petition for writ of certiorari to the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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